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Report on opinion survey on price-level adjustment of depreciation

American Institute of certified Public Accountants. Technical Services Department

Report On

OPINION SURVEY ON PRICE-LEVEL ADJUSTMENT OF DEPRECIATION

Conducted By

Technical Services Department

American Institute of Certified Public Accountants

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INTRODUCTION

In July, 1957, questionnaires were sent from the Research Department of the American Institute of Certified Public Accountants to a selected list of 669 corporate executives and educators, soliciting their opinions as to certain problems relating to the disclosure of the effect of price-level changes upon depreciation of plant and equipment. The questionnaire is shown as Appendix A of this report. It covered the following points: the general desirability of disclosure of current dollar cost of depreciation in corporate reports to stockholders, methods of disclosure, whether or not such disclosure should be mandatory, the effect of the acceptability of current cost depreciation for income tax purposes upon the desirability of disclosing an adjusted net income figure, the effect of technological changes as a possible counterbalance to the effect of price-level changes, and the effect of recent additions to plant and equipment as an offset to the price-level problem.

Completed questionnaires or letters of comment were received from 406 individuals, representing 331 business firms and including 75 educators. The following report presents a summary and an analysis of the opinions of this group.

HIGHLIGHTS

Varying opinions were expressed on each of the questions which were raised in the survey. The following brief summary, however, may be said to present roughly the majority opinion.

> Assuming that an acceptable means of measuring price-level changes is available, the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders.*
>
> Present methods of reporting depreciation should be left undisturbed in the financial statements, but disclosure of current dollar cost of depreciation should be made in a supplementary manner, preferably as a footnote to the financial statements.
>
> Of those who approved disclosure of current dollar cost of depreciation, a small majority favored mandatory disclosure.
>
> Much stronger support for disclosure of current dollar cost of depreciation would be obtained if such amounts were deductible for income tax purposes. Those who were in general in favor of disclosure were about evenly divided as to the desirability of presenting an adjusted net income figure in the absence of the acceptability of current dollar cost depreciation as an income tax deduction.
>
> While technological changes often eliminate the problem of literal replacement of property, they do not counterbalance the effect of rising price levels.
>
> While in some cases recent acquisitions of plant may have reduced its significance, they have not generally taken care of the price-level problem.

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*A survey on the same subject was conducted by the American Institute in 1948. No attempt has been made to compare the results, because both the samples of individuals questioned and the questions themselves were quite different. However, the answer to the first question in the 1948 survey may be of interest. This question was: "Do you think that a substantial change in accounting methods is necessary to provide a satisfactory reporting of corporate income in view of recent changes in price levels?" Of the respondents in 1948, who included practising accountants, economists, lawyers and security analysts, as well as business executives and teachers, 28 per cent answered "yes" to this question, while 72 per cent answered "no."

GENERAL REACTION

The general reaction to the effect of price-level changes upon depreciation appeared to be that stockholders should be made aware of the effect in some manner, and, by a small majority, that disclosure of the amount of current dollar cost of depreciation should be a mandatory requirement. These conclusions are drawn from the answers to questions 1 and 3 in the questionnaire, which are therefore presented together in this report before giving the answers to question 2.

Question 1 was:

> In view of changes in price levels, and assuming for the purposes of this question that an acceptable means of measuring such changes is available, do you think that the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders?

The answers to question 1 are shown in Table I. They show a ratio of about 3 to 1 in favor of reflecting the current dollar cost of depreciation in reports to stockholders, which would be reduced to about 2 to 1 if the last two groups, Finance and Insurance (largely financial analysts and credit grantors) and Educators, were eliminated. In only three groups of companies, Petroleum; Food, Drugs, etc.; and Retail and Services were less than half in favor of such disclosure. As might have been expected, stronger support is found among the companies having a relatively large investment in depreciable assets than among those where depreciation is a relatively small part of operating costs.

Table I

Question 1 - General Reaction

Group	Answers* Yes	Answers* No	% Yes	% No
Automobile, Aircraft and Related Industries	16	7	70%	30%
Building Materials	11	4	73	27
Machinery and Equipment	31	11	74	26
Chemicals, Paper, etc.	16	4	80	20
Railroad Equipment, Shipbuilding and Shipping	8	3	73	27
Steel	8	0	100	0
Mining and Metals	10	2	83	17
Petroleum	5	7	42	58
Food, Drugs, Beverages and Tobacco	13	14	48	52
Other Manufacturing	22	6	79	21
Retail and Service	6	8	43	57
Railroads and Public Utilities	10	8	56	44
Finance and Insurance	28	7	80	20
	184	81	69%	31%
Educators	62	4	94	6
Total	246	85	74%	26%

*Without comment or qualification. An examination of the other 28 answers which were received indicates that the ratio of those which might be interpreted as "In general, Yes" to those which might be interpreted as "In general, No" was about 2.4 to 1.

Reasons for Approval

Although the questionnaire did not ask for reasons for the answers, a good many letters of comment and explanation were received which often indicated the reasoning which led to the answer to the first question.

The most common type of justification for a general approval of disclosure of the effect of price-level changes was that unless operating expenses reflect current dollar costs of depreciation, they will be understated, and, as a result, net income will be overstated, income taxes will be inequitably high in many cases and often will partly be paid "out of capital," and dividends may in part represent a return of capital rather than a distribution of earnings.

> There is no question but that the continuing inflation of prices is a serious problem, and that one of its effects is probably an understatement of the real costs involved in the wearing out of facilities; to the extent that taxes and/or dividend payments are made on this overstatement of income, there is a real diminution of capital in a given concern. (Chemicals)

> I should like to state that in my opinion, the capital goods industry can not survive if it continues to pay income taxes and dividends out of capital. Certainly something must be done to recognize the reality of inflation both for tax and corporate purposes. (Metal Fabricating)

> If inflation were to continue at the pace of the last ten years, there would be a great need for recognition of current value depreciation for tax purposes. Experience over the last ten years indicates that income tax then becomes partially a capital levy. (Retail)

> I feel strongly that current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders to prevent misleading overstatement of profits. At the same time, it is perhaps more important to obtain a revision of the income tax law to allow a practical procedure for decuting current cost depreciation from taxable income. (Steel)

> We, with many others, have recognized this problem for many years and consistently have been in favor of the adoption, both for corporate and tax purposes, of some realistic and reasonably flexible method by which the allowance for depreciation will enable the taxpayer to properly reflect his purchasing power expended. The current cost of labor, materials, and facilities used in producing the items sold, together with the taxes which must be paid, represent the true costs of a going concern. As a matter of good business practice, income statements should reflect these true costs on a consistent basis from year to year. The present practice of computing depreciation on original cost results in an inconsistent basis in periods of changing cost levels...Taxes paid because of a depreciation deduction which is not sufficient to recover in current dollars the purchasing power originally expended are taxes paid out of capital. (Steel)

> For a long time I have felt that not permitting a corporation to depreciate at replacement value rather than at actual cost in effect amounts to asking the corporation to pay at full corporate rates an income tax on what is actually a capital gain. (Insurance)

> The Federal Government is presently taxing industry in part for non-existent profits. (Paper Products)

> From an investment point of view, the adoption of price level depreciation, or at least the exposure of earnings figures on this basis, would correct the overstated earnings of a number of smaller companies or of those in stable industries who only replace plant over fairly long periods of time... (Financial Analyst)

Another similar line of reasoning assumes that the charges for depreciation should provide for the replacement of depreciable assets or for the maintenance of productive capacity. It was argued that this will not be accomplished unless the depreciation charge includes the effect of the higher price level.

> The effect of inadequate depreciation on our financial picture is critical. First, we cannot possibly recover, through annual depreciation charges, amounts sufficient to provide for replacement at today's prices. Second, our recorded manufacturing costs are understated, since the actual current value of the assets consumed each year is far more than the allowed depreciation charge based on original cost. Third, it follows that this produces an overstatement of earnings in terms of current dollars and a corresponding overpayment of Federal income taxes. Fourth, because we are prevented taxwise from generating

enough cash from internal sources to pay the full cost of plant rehabilitation, we are of necessity forced to borrow from outside sources to provide adequate production facilities and to keep our plants in good operating condition. (Cement)

This inflationary trend is, of course, a matter of serious importance to all of us who have to replace the equipment and physical assets of our companies on a more or less continuing basis in order to stay in business. The replacement cost of the new machine far exceeds that of the machine which it replaces and the depreciation reserves which have been accrued are in most cases totally inadequate. This added cost must be recovered in some fashion or the only other alternative is to raise additional capital to make up the difference. As long as the Federal Government has not seen fit to recognize depreciation charges in any other manner than that related to the historical cost of the depreciable asset, any charges in excess of such amounts are not deductible for tax purposes. If such charges are made to the income account without the benefit of tax deductions, the reported earnings of the company are materially reduced. On the other hand, in not recognizing this cost, the reported earnings are probably overstated from what is the true amount. (Chemicals)

We should like to state that we feel very strongly concerning this matter of depreciation, and favor any method that can be arrived at to afford higher depreciation rates, particularly for income tax purposes, so that more of our current earnings can be retained for the purpose of replacement of old and obsolete equipment. With the continued increase in costs of new equipment, it becomes almost impossible to obtain the necessary capital to make replacements at the proper time. (Food)

We think a satisfactory solution to this problem is vital if industry is to remain in its present healthy condition. There can be no doubt in the minds of understanding people that industry has not, and, under presently accepted accounting practices, cannot recover through depreciation the full value of its investment in plants and facilities. This means, of course, that additional funds must be put into new facilities simply to maintain productive capacity at a constant level and that profits are overstated to the extent that such additional funds are required. (Aluminum)

The failure of cost basis depreciation to recognize inflation results in the draining of working capital merely to maintain existing plant investment and capacity. Income taxes paid because the basic depreciation is insufficient are in effect taxes paid out of capital, and this fact should be recognized by industry and the taxing authorities. (Metal Fabricating)

Because depreciation based upon historical costs has not provided sufficient funds to meet replacement costs, industry's reported earnings have been overstated and in effect the income taxes have represented a tax on capital. (Petroleum)

Certainly the accounting profession should recognize that any amount that must be reinvested in the business to maintain assets at the same level of productivity cannot constitute profit. (Petroleum)

Unless a means is devised for long-lived assets along the lines of LIFO for short-lived assets to permit the recovery of additional current replacement cost through charges to income, the result can only be a powerful deterrent to growth and expansion. Since taxes consume more than half of income, it follows that any treatment in the accounts solves only half the problem unless such replacement depreciation is allowed for tax purposes. (Steel)

It is our policy to base our annual depreciation charges on historical costs, but due to the continued inflationary trend of cost of improvements or additions to our property, the fund is insufficient to meet the needs and we find it increasingly difficult to find or provide the necessary cash for such improvements. We believe if it were possible to secure help in raising these funds through increased depreciation charges based on present day replacement cost, the problem would be partially solved. (Railroad)

As opposed to the requirement for accounting for historical cost consumption, it seems to me that depreciation should include a provision for current price level adjustment as a means of maintaining the capital of the business. Under this concept, the financial statements would recognize the consumption of original investment caused by continued inflationary trends and eliminate the fallacy of profits as presently being reported. (Gas Distribution)

I think original cost depreciation is no longer realistic, and it is important to progress toward making provision for replacement of plant not provided for through cost depreciation. (Gas Distribution)

Other replies emphasized the need of the investor for information as to the effect of price level changes upon depreciation. It was felt that the withholding of such information might cause a stockholder to be misinformed about his investment.

> My personal view is that corporate financial statements, as presently issued, are sadly defective with respect to such cost and also with respect to the valuation of fixed property. By not reflecting the progressive deterioration in the value of our currency, they perpetrate a wholesale and growing deception upon the investing public. (Auto Parts)

> I feel that stockholders are entitled to full disclosure as to the permanence of their investment. They should be told everything that may affect the future of the business. Not to give price level depreciation information may cause a stockholder to be misinformed about his investment. (Educator)

> ...we must aid the investor and the stock market to make the adjustment in their thinking between overstated earnings resulting from the calculation of depreciation based on original cost and realistic earnings resulting from depreciation based on current cost. The realistic earnings will, in many cases if not in most cases, be considerably lower and the yardsticks which investors use must be adjusted accordingly. For this reason I feel it is important, even though depreciation on current cost is the correct method, that the difference between depreciation on current cost and depreciation on original cost be so shown as to aid the investor to adjust his thinking to the new method. (Machinery)

Reasons for Opposition

A number of reasons were given for opposing the disclosure in the annual report of the effect of higher costs upon depreciation.

A common opinion was that most stockholders would be confused or misled by the introduction of new concepts or supplementary figures.

> We are of the opinion that adjustments to the actual dollar cost of depreciation to indicate inflationary trends would only serve to confuse most stockholders. Inasmuch as most of the public have little knowledge of accounting matters, it would also appear that they might be misled into decisions they might not otherwise make. (Aircraft Parts)

> The average stockholder does not understand accounting, especially when it involves non-cash items like depreciation. Those who have learned to read stockholder reports would have difficulty in understanding depreciation on a current

cost basis. Many fail to understand depreciation anyway. Even investment analysts are emphasizing "cash" earnings. (Building Materials)

We believe that any such attempt could only lead to a greater confusion and lack of understanding of corporate reports than exists today. (Electronics)

We believe the information furnished to our stockholders is very complete and no particular benefit would accrue from presenting them with a price level comparison of current depreciation. It might even be misleading in that such a figure could bear little relationship to the amount required to be set aside from income for actual replacement of facilities. Presumably a shareholder can make adjustments to income to allow for inflationary forces (remembering that many more items than depreciation are affected) if he so chooses...Incidentally, we have never received any comments or questions from our shareholders concerning the subject of income correction for price level changes. (Electronics)

I feel that the word "depreciation" should be used to describe only the periodic charge to current income for a proportionate share of the investment made in some prior period. Only confusion can result by attempting to stretch this term to include the cost of replacement facilities or the economic differences in our dollar currency. (Food)

We feel that the present method of reporting depreciation charges in terms of historical cost rather than in terms of current dollars is satisfactory to meet the needs of shareholders and other readers of financial statements. We do not believe that the reports would be more useful if they reflected the current dollar cost of depreciation as well as its historical cost , as it would not increase the comparative usefulness of income figures, and may tend to confuse the readers if some companies reported depreciation on appraisal values while others adhered to historical costs. (Machinery)

...I don't believe the idea has any value to stockholders as I believe they would not have sufficient information to interpret its significance. (Mining)

It seems to us that to attempt to recognize current prices in providing for depreciation charges would only tend to confuse the readers of financial statements. (Petroleum)

Our present method of handling depreciation at least is definite and is clearly understood, whereas I would think the very flexibility of assumptions based on changes in the price level, inflation or deflation, would introduce an area of uncertainty in reading reports and would not be as accurate a method of reporting to our stockholders as the one we now have. (Retail)

If the original cost were to be adjusted by means of price indices to an estimated replacement or current cost, the explanation of such adjustment could very well be confusing. Furthermore, the necessity of subsequent adjustments, as indices fluctuate year by year, would further confuse the picture. (Mail Order)

...we do not feel that this would serve any purpose as far as balance sheet presentation is concerned, and any notes to financial statements in this regard would, in our opinion, tend to be misleading to many stockholders. (Shoes)

It seems to us that insofar as the layman is concerned, it would be most confusing if a company were to issue its statements showing certain figures only to qualify them by reference to another set of figures. (Unclassified Manufacturing)

Unless a new method of reporting has incontrovertible advantages there seems little merit in accepting it in lieu of a method which is widely understood and has a sanction of long usage. (Unclassified Manufacturing)

My associates and I feel that the introduction of this particular additional complication at this time would certainly be confusing to the rank and file investor who is interested and trying to understand the annual reports sent to him by those companies in which he is a stockholder. (Unclassified Manufacturing)

The added information would frequently confuse stockholders. (Bank)

A departure from conventional reporting could only create confusion and doubt and possibly result in increases in costs of additional investment funds which are continuously required for plant replacement or expansion. (Electric Utility)

A good many were concerned about the technical difficulties in making adjustments to a current cost basis. They were inclined to doubt that there could be an "acceptable means of measuring such changes."

Involved would probably be an annual appraisal, either physical or statistical, to determine current replacement values... /There would be/ too great a margin for error in appraising asset replacement values /and/ the state of our national economy. (Aircraft)

The mechanics of maintaining a system of evaluation of depreciation would be far from an exact science, leaving the accuracy of statements, where depreciation is a large item, completely to the discretion of the estimator. (Aircraft Parts)

A change to current cost depreciation imputes an accurate mathematical measurement to the provisions under the then current conditions. Yet such provisions are inaccurate on all bases except as an accounting convention. (Building Materials)

At the present time, I do not believe that inflation has reached the point where the recognition of replacement value in the accounts is sufficiently important to overcome the practical difficulties of making an accurate computation of "true" depreciation, and, therefore, do not believe the time is yet with us to give cognizance to inflation in property and depreciation accounting. (Chemicals)

My own feeling is that the matter is much more complicated than would be indicated by the questions... Practically every item in the balance sheet and operating statement would be affected to some degree by the inflationary trend in the future as well as in the past, and it would be quite a job to accurately reflect the effects of changing trends. When consideration is given to income taxes, the picture becomes even more complicated and would appear to afford the accountants a wide field to roam. (Electronics)

...the possibility of going back to provide a price level depreciation on property previously fully depreciated and still in use - which would be necessary to be consistent - would be appalling. (Electronics)

At best, only rough estimates could be computed and these could have some serious limitations in providing fairly accurate and consistent reporting. (Fertilizer)

The determination of replacement costs would be a formidable task and would have to be repeated annually. (Food)

...unless there is an acceptable standard to adjust to current dollars it would become extremely difficult to judge the propriety of the amounts of depreciation charged to current income and the significance of such accounting treatment on current and future profits. Any attempt to furnish the cost of depreciation in current dollars, either as an explanatory footnote or in a supplementary statement, does not appear to be practical in view of the effort necessary to determine the amount through the calculation by price index applied to expenditure in years when acquired and judgments or estimates that may be required to arrive at a proper amount. (Machinery)

...we are inclined to feel the accounting task relating to full recognition of this principle might be costly. (Machinery)

Perhaps our opinion that accounting adjustments should not be made for changes in price levels has been unduly influenced by our inability to assume or imagine that an acceptable means of measuring such changes is available. (Machinery)

...the difficulties in applying the principle and the impossibility of insuring the uniform treatment necessary to make the accounts of hundreds of companies properly comparable, would make the scheme impracticable. (Petroleum)

...the difficulties involved in devising a medium which would be meaningful and, at the same time, independent of the possibility of manipulation by government or others have been so great as to seem insurmountable. (Petroleum)

It would have seemed more appropriate to delay the issuance of this type of a questionnaire until a method of determining depreciation at current dollar cost is fully explored and developed. The manner of showing the depreciation in financial statements is of relative unimportance compared with the prime problem of determining such depreciation. (Retail)

Many small companies would have inadequate records for the necessary calculations and would find the system very confusing. Management of many companies, particularly small companies, would strenuously object to the additional cost involved in the necessary accounting and preparation of reports. An acceptable method for measuring the changes in price levels might be exceedingly difficult to establish. (Bank)

We doubt that it is reasonable to assume that an acceptable means of measuring such changes can be worked out. (Bank)

I think that my misgivings lie chiefly in the difficulties of measuring the real changes rather than in recognizing that such changes are taking place. (Educator)

...I am unwilling to accept the assumption /that an acceptable means of measuring such changes is available/. (Educator)

Problem is to develop acceptable means of measuring increased costs for specific companies. Cannot be a general rule in that inflation forces vary between types of enterprises. In other words, I believe in it but question if a solution can be found. (Educator)

...while I can conceive that an acceptable means of measuring the "current dollar cost of depreciation" for certain companies and industries might be developed, I strongly doubt whether any system could be devised which could be applied uniformly to all companies. Unless one could, I would be opposed to any change. (Financial Analyst)

A number of comments stressed the factor of technological developments which would reduce or eliminate the significance of replacement costs.

> ...when additional equipment is purchased in the future, perhaps at increased cost,...technological improvements will tend, to some degree, to compensate for the additional cost of equipment. (Shoes)

> We do not think it would be realistic to simply apply construction cost indices to this depreciation, since this would not measure the real costs of replacing an existing station with a new modern station in which larger units and advances in the art have offset the effects of inflation to a substantial degree. (Electric Utility)

> Plant that is retired at the end of its useful life is never replaced by a similar plant but most advocates of current cost depreciation assume that the corporation should have dollars reserved sufficient to duplicate such plant... No cost index that I have ever seen has taken into account increased efficiency... (Electric Utility)

> ...the greater productivity of new plants and machinery is a factor which must be taken into consideration and at the same time is one which will vary considerably from one industry to another. (Financial Analyst)

> We are reluctant to hold much hope for the scientific development of a common index, which would be generally unassailable, from the point of view of day-to-day inflationary changes, large areas of inapplicability, the various methods in force relative to estimated life of capital goods, real hardship cases, establishing the relationship of the year of acquisition, and recognition of the counter-effect of true cost increases, mass production cost reductions, technology, design, speed and utility of function changes, etc. (Machinery)

> Certainly in most cases a new facility built with current dollars would be more efficient and less costly to maintain than one which is five, ten or fifteen years old. Therefore providing depreciation on an old facility based upon current construction dollars, with no recognition of other factors, would not give a realistic picture of earnings. (Electronics)

> ...if facilities were replaced, management would be in a position to improve the efficiency per dollar of plant investment. Unless this improvement in efficiency is reflected in the operating statement, the increased charge as

indicated in the depreciation item would be meaningless. (Electronics)

...in the case of old office buildings, it would no doubt be misleading to adjust the value of these upward on the basis of the original cost when modern taste, architecture and demand do not require the costly "gingerbread" construction of several decades ago. Likewise, in the case of industry, new concepts and practices have entirely changed to make processes of thirty years ago obsolete. An old process may be still used <u>only</u> because of a small depreciation charge or <u>no</u> depreciation charge. (Fertilizer)

It has, of course, been well known for many years that a machine which originally cost $5,000 now costs $20,000 and that if we are accumulating depreciation on the old machine we are obviously not going to have enough to buy the new. The new is admittedly far better than the old but by and large that is not the answer to the question. The real answer is that manufacturing is trying to arrive at new methods of doing things and consequently would in many instances not be replacing the old with a similar new machine but with an entirely new method, which has no particular relation to the old equipment. (Locomotives)

As we see it, the major problem of the chemical industry in the area of providing adequate depreciation is obsolescence of process and product rather than physical wear and tear of facilities. This results in less emphasis on replacement of facilities in kind (as is the case in some industries) and more emphasis on providing plant facilities geared to changes in industry technology directed to maintenance of earning power. Thus, any rule for the use of a cost index to factor up historical dollar plant cost for calculation of current dollar depreciation should be flexible enough to accommodate the "maintenance of earning power" problems of the chemical industry. (Chemicals)

You will note that we have answered the first question... in the affirmative, however, the..."acceptable means" necessarily must provide for a reasonable determination of that portion of increased costs of facilities resulting from technological improvements. (Automobiles)

Some opposed disclosure of current cost depreciation on the ground that the problem was one of financing higher replacement or capital costs, which would involve a retention of net earnings rather than a modification of the depreciation charge.

It seems a more realistic approach to the problem would be to rely upon the judgment of the accounting profession to ensure that earnings are not withdrawn from the business to the extent that its ability to replace such property would be in jeopardy. (Aircraft Parts)

It is our feeling that the purpose of the depreciation charge is to amortize the net cost of a capital asset over its expected useful life, and not to provide the funds to replace the asset at replacement cost - which is a problem of the management of cash resources... It would seem that a sound way to regard this problem would be to understand that earnings reflect depreciation taken on an original cost basis, but that a portion of every dollar earned is required to pay for the replacement of capital assets at costs in excess of those provided for by accumulated depreciation reserves. (Building Materials)

I am afraid that many uninformed members of the business community are augmenting the price level problem by confusing the reporting of net income with the budgeting of cash requirements including those necessary for plant replacement. In fact, I am afraid that some have gone so far as to believe that an increase in depreciation allowances will automatically produce additional funds over and above any possible savings in taxes. (Containers)

I see no more reason why depreciation reserves should be plussed for something that might be done in the future any more than setting up reserves for higher possible labor costs, advertising costs, etc. ...accounting is not a substitute for financial management. (Mining)

Asset replacement is a matter of financing. Assuming that price increases on replacements are to be financed out of earnings, it then becomes a matter of surplus retention. Earmarking a portion of surplus as a property replacement reserve should be a more direct and understandable method of retaining the necessary capital, rather than increasing the depreciation charge on the income statement. This surplus designation should be subject to management's discretion, since its purpose is primarily explanatory to the stockholders because of its possible effect on dividend policy. (Mail Order)

...if our purpose is to measure expenses as related to the income for a certain period, any adjustments to depreciation charges would present a distorted picture. We would be trying to relate future costs to current selling prices, which, in most industries could not be increased to cover expenses which will be higher in future periods. (Shoes)

Of course, new fixed assets may cost more than the old ones. It is management's responsibility to have the funds on hand when they are needed for the purchase of fixed assets. The funds may come from those provided by earnings or from the sale of new stock or bonds. Depreciation expense and the accumulation of funds are two different things. (Educator)

> While there might be some benefit in stating earnings on the basis of replacement cost depreciation because it would permit a company's dividend policy to be adjusted downward, we do not believe that this would be a real advantage. Dividend policies can be decided upon with full recognition of the need for retaining earnings in a reasonable amount. (Food)

Some of those who submitted general comments did not appear to oppose the disclosure of adjusted depreciation, but answered "No" because the amount of the adjustment would not be significant in their companies.

> We believe that in the case of this corporation the present method of reporting depreciation based on historical cost is satisfactory... Most of our...warehouses...have, due to their age, been heavily depreciated and still have many more years of useful life. It is not conceivable that they would have to be rebuilt except in the event of destruction by fire ... A large part of our...equipment has been replaced in the past five years at current dollar costs... (Liquor)

> We believe that /recent additions/ plus the fact we have been using the sum-of-the-years'-digits method...accomplishes the purpose of reporting our depreciation dollars on a reasonable current basis. (Brewing)

> ...in our opinion the accelerated rate of depreciation and amortization on certified facilities, the unit rate of depreciation of...producing properties, and the rates on technical...plants used by our company result in a reasonable annual charge against earnings. (Petroleum)

> We do not believe that price level depreciation presents a very significant or important problem for our company or for others in our industry where our capital investments in relation to sales volumes are not as large as they are in many other industries. (Drugs)

> ...depreciation is less than $10 million a year out of cost of goods sold of over $700 million and, for this reason, does not have the same significance for this company that it does for many others. (Food)

> ...this industry has not been subject to the same capital expansion as other industries where the inflationary trend in the matter of depreciation is more significant. (Mining)

> ...in our case, our principal assets are relatively new, having been acquired within the last two to three years. Many of our older assets were subject to rapid amortization under certificates of necessity for which income was penalized

in those years. Therefore, any price level change in depreciation as we would compute it would not be material. (Electronics)

With limited additions between 1932 and 1941, the majority of pre-war depreciable assets have been fully depreciated. We have made substantial additions to properties over the last ten years, with more than 50% in the last four. During the ten year period the charge for depreciation has doubled. This seems to me to indicate that, in our case, our accounts are presently substantially reflecting costs on a current basis. (Retail)

The problem is not materially significant to our Company because substantially all the real estate we use is occupied under lease and substantially all the equipment we use has a relatively short...life. (Retail)

Since manufacturing facilities and equipment used in [our] business, to a greater degree than in other industries, are on a rental or royalty basis, the problem of increased cost of replacement equipment is not as great as in other industries and our thinking in this regard may be influenced by that fact. (Shoes)

I would like to point out that with respect to our company, depreciation, as shown in our annual report to the stockholders, amounts to less than 1-1/2% of the total sales dollar. It is obvious, therefore, that even with a change in the price level, depreciation is not a material factor in reporting our earnings. (Unclassified Manufacturing)

No, as it pertains to our company, because depreciation is not that important a cost element. (Vegetable Oils)

A number of other reasons for favoring or opposing price level adjustment were given in individual instances, such as an undesirable effect during a downswing of prices, and the possible discouragement of investment in the industry if current cost depreciation were disclosed. Some gave their approval only if current costs were allowed for income tax purposes, in government contracts, for rate regulation purposes, etc.

Mandatory Disclosure

Question 3 was:

> If you think the effect of price level changes should be recognized, do you believe there should be a mandatory requirement for disclosing the amount of current dollar cost of depreciation?

The answers to question 3 are shown in Table II. Those who favored the recognition of the effect of price level changes were about evenly divided as to a mandatory requirement for disclosure of the amount of current dollar depreciation, a small majority being in favor of mandatory disclosure.

Those who favored mandatory disclosure and gave reasons for their opinions emphasized the desirability of a uniform procedure. A few approved mandatory disclosure providing current cost depreciation were allowed for income tax or rate regulation purposes.

Table II

Question 3 - Mandatory Disclosure

Group	Answers* Yes	Answers* No	% Yes	% No
Automobile, Aircraft and Related Industries	8	8	50%	50%
Building Materials	6	5	55	45
Machinery and Equipment	14	19	42	58
Chemicals, Paper, etc.	8	6	57	43
Railroad Equipment, Shipbuilding and Shipping	5	2	71	29
Steel	3	5	37	63
Mining and Metals	4	6	40	60
Petroleum	1	4	20	80
Food, Drugs, Beverages and Tobacco	10	4	71	29
Other Manufacturing	11	12	48	52
Retail and Services	4	3	57	43
Railroads and Public Utilities	6	3	67	33
Finance and Insurance	10	18	36	64
	90	95	49%	51%
Educators	36	28	56	44
Total	126	123	51%	49%

*Without comment or qualification. An examination of the 25 other answers which were received indicates that a majority would be in favor of mandatory disclosure.

If current value depreciation is to be seriously considered, it should be mandatory. We think it would be a mistake to permit some to report on that basis while others do not, each for their own reasons. (Retail)

Although mandatory reporting would be objectionable, it would be desirable for purposes of comparison within an industry to develop more uniform practices on this and other accounting matters. (Chemicals)

The efforts in prior years of forward thinking enterprises to recognize the inadequacy during inflationary periods of cost basis depreciation were abandoned, primarily because the investing public and the business community were not then ready to accept the new concepts of depreciation. It seems to us that acceptance of the principle will be more quickly achieved and the principles adopted on a more uniform and reasonable basis if the recognition of a price level change is a mandatory requirement. (Metal Fabricating)

Yes, because if it were not mandatory the present problem of comparing results of various companies might still exist and confusion on the part of readers of statements might be greater. (Aluminum)

It is my thought in answering "yes"..., that uniformity is quite desirable from our viewpoint. In a broader sense, I also feel that such a requirement would be an effective way of providing the facts of inflation to more people. (RMA)

Those who opposed such a requirement preferred to leave the matter to the judgment of the management because of the variations in significance of the item, the cost and difficulty of making the necessary calculations, and other such factors.

No, but if disclosure gains fairly wide acceptance, it may be desirable to require that reports state whether or not they give any recognition to current dollar depreciation. (Farm Equipment)

We strongly oppose this... Companies who could not do so at reasonable cost, should not be required to show current depreciation costs. (Food)

We do not believe that such a requirement should be mandatory. In some companies investment in plant is not material in relation to total assets, just as in some companies, such as those in the contracting industry, the method used in pricing inventories is not a serious concern. Decision, therefore, should be left to the discretion of the Board of Directors and company management as is now the case in the use of the Lifo inventory method. (Steel)

I would not be in favor of a mandatory requirement applying to all companies calling for the disclosure of current cost depreciation, since, depending upon the nature and amount of a company's fixed assets, the problem might not be an important one and the requirement, therefore, might merely cause additional work. (Steel)

In the present state of development of this whole matter, it is believed that the answer should be "no." (Railroad Cars)

We also believe that there should be no mandatory requirements in regard to such reportings and that the desires of management should be given the greatest possible latitude in selecting the means of reporting, so long as the picture given is consistent and meaningful insofar as the particular operations of the company are concerned. (Petroleum)

..."No" because there are such varying factors affecting different industries that lead us to feel that the decision should be left up to the judgment of the management involved. (Tobacco)

A general practice seems desirable. However, it is hard for me to subscribe to "mandatory requirement" without knowing more of the possible method of implementation. (Gas Distribution)

METHOD OF DISCLOSURE

The second question presented four possible methods of disclosing or presenting the current dollar cost of depreciation in the reports to stockholders, which can briefly be described as: (a) footnote disclosure, (b) supplementary income statement, (c) adjusted income statement, and (d) adjusted balance sheet and income statement. An expression of opinion was requested as to which methods were acceptable and which one was preferable. Replies without comment or qualification were received from 238 of the 246 individuals who indicated in their answers to the first question that in their opinion "the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders."

The results as to the preferred method are indicated in Table III. No one method received the support of a majority of those replying, but the largest number preferred footnote disclosure. Less than half, 41%, would revise one or both of the principal financial statements, while 59% preferred to use either a footnote or a supplementary income statement. A more detailed analysis of the answers to this question follows.

Table III

Summary of Preferred Methods of Disclosure

Group	Number of Replies* Total	(a)	(b)	(c)	(d)	% of Replies (a)	(b)	(c)	(d)
Automobile, Aircraft and Related Industries	16	8	1	3	4	50%	6%	19%	25%
Building Materials	7	3	1	3	0	43	14	43	0
Machinery and Equipment	29	14	4	9	2	48	14	31	7
Chemicals, Paper, etc.	16	8	1	5	2	50	6	31	13
Railroad Equipment, Shipbuilding and Shipping	7	3	1	3	0	43	14	43	0
Steel	5	0	0	4	1	0	0	80	20
Mining and Metals	11	5	1	3	2	46	9	27	18
Petroleum	4	0	1	3	0	0	25	75	0
Food, Drugs, Beverages and Tobacco	12	7	1	3	1	59	8	25	8
Other Manufacturing	19	11	2	4	2	57	11	21	11
Retail and Services	5	2	0	3	0	40	0	60	0
Railroads and Public Utilities	10	4	2	2	2	40	20	20	20
Finance and Insurance	33	15	8	7	3	46	24	21	9
	174	80	23	52	19	46%	13%	30%	11%
Educators	64	14	24	12	14	22	37	19	22
Total	238	94	47	64	33	39%	20%	27%	14%

*Without comment or qualification.

Method (a) - footnote.
Method (b) - supplementary income statement.
Method (c) - adjusted income statement.
Method (d) - adjusted balance sheet and income statement.

Method (a) - Footnote Disclosure

Method (a) was described as:

> Report net income in the presently accepted manner with an explanatory footnote disclosing cost of depreciation in current dollars.

The opinions as to the use of a footnote are shown in Table IV. Of the non-educators who replied to this question, 59% considered this method to be acceptable and 46%, the largest for any of the four methods, considered it to be preferable. It received substantially less support from the educators, only 31% considering it to be acceptable, and 22% preferable.

Table IV

Question 2(a) - Footnote Disclosure

Group	Acceptable No.*	Acceptable %#	Preferred No.*	Preferred %#
Automobile, Aircraft and Related Industries	10	63%	8	50%
Building Materials	4	57	3	43
Machinery and Equipment	16	55	14	48
Chemicals, Paper, etc.	11	69	8	50
Railroad Equipment, Shipbuilding and Shipping	3	43	3	43
Steel	1	20	0	0
Mining and Metals	7	64	5	46
Petroleum	3	75	0	0
Food, Drugs, Beverages and Tobacco	9	75	7	59
Other Manufacturing	14	74	11	57
Retail and Services	3	60	2	40
Railroads and Public Utilities	5	50	4	40
Finance and Insurance	16	48	15	46
	102	59%	80	46%
Educators	20	31	14	22
Total	122	51%	94	39%

*Without comment or qualification.

#Of replies received from each group to this question.

In addition to the direct and unqualified answers shown in Table IV, several comments were made on this method of disclosure.

> A clearly stated footnote seems preferable to a complete supplementary statement, which might be confusing to the average reader of Annual Reports. (Chemicals)

> I believe very definitely that this serious matter should be forcefully brought to the attention of the company stockholders as well as the general public or prospective investors. I think the most appropriate way of bringing it to their attention is through some footnote which would be appended to the income account. It seems to me that incorporating such charges directly in the accounts would, in all probability, make for confusion and non-comparability of corporate statements... Consequently, to get the message across, an explanatory footnote with basis of calculation (which at the best must be an estimate) should ge given and the actual corporate records kept in the orthodox accounting manner consistent with prior years. (Chemicals)

> In general, we feel it might be helpful to the public if financial statements included a footnote indicating current replacement value of depreciation charges as possible support for a well formulated program of profit retention, provided the footnote also recognizes the corresponding inflationary effect on related residual capital assets. (Machinery)

> /Preferred/ provided such depreciation is allowed in determining rates. (Telephone)

> It is our feeling that an acceptable manner of calling attention to the additional provision necessary to bring depreciation charges up to the current replacement cost basis would be to (1) include this as a comment in the financial portion of the report, or as a footnote to the financial statements, /and/ recognize this as a financing problem, and...provide an appropriation of current earnings... (Aircraft)

> ...we feel that until the public is more generally acquainted with the financial problems created by inflation (or deflation...) it is more advisable to call these matters to the shareholders' attention by footnotes or through the chairman's letter rather than to further complicate the financial statements themselves. (Auto Parts)

> We believe that recognition of the difference between actual cost and replacement value of facilities and the related effect on depreciation and profit should be limited to an explanatory statement... Changes in the price level should not distort depreciation charges as a reflection of the spreading of actual cost over expected life. (Rubber and Tires)

> ...I feel that every company should give in some detail the type of depreciation policy it is applying... measured in dollar amounts as well as percent of total plant, and use footnote technique to show income and balance sheet changes from the reflection of current dollar costs. (Financial Analyst)

> ...at this time I would oppose giving any figures of current dollar costs of plant and equipment and depreciation in footnotes. No matter how carefully the footnotes were worded, many misinterpretations of the company's financial position by the non-professional accountant and the investor would arise from these notes. (Electric Utility)

> Its being shown as a footnote may have a questionable value. Footnotes are given a secondary importance in the reader's mind. (Retail)

In two instances a preference was expressed for footnote disclosure where the answer "No" was given to the first question.

Method (b) - Supplementary Income Statement

Method (b) was described as:

> Report net income in the presently accepted manner, accompanied by a supplementary statement which reflects current dollar cost of depreciation and the adjusted net income.

The opinions as to the use of a supplementary income statement are shown in Table V. This method received little support from the non-educators, only 27% considering it to be acceptable and 13% preferable. It received the strongest support of any method from the educators, 54% considering it to be acceptable, and 37% preferable.

A few comments were made on this method in addition to the statistical results shown in Table V.

> Method (b) has been selected as most acceptable in the belief that it would be least confusing to the stockholder and would enable the development and the presentation of the information in the most understandable manner. (Railroad Cars)

> We hesitate on (b), because we believe that two income statements can cause unnecessary confusion. (Aluminum)

Table V

Question 2(b) - Supplementary Income Statement

Group	Acceptable No.*	Acceptable %#	Preferred No.*	Preferred %#
Automobile, Aircraft and Related Industries	2	13%	1	6%
Building Materials	3	43	1	14
Machinery and Equipment	8	28	4	14
Chemicals, Paper, etc.	2	13	1	6
Railroad Equipment, Shipbuilding and Shipping	2	29	1	14
Steel	0	0	0	0
Mining and Metals	2	18	1	9
Petroleum	2	50	1	25
Food, Drugs, Beverages and Tobacco	2	17	1	8
Other Manufacturing	5	26	2	11
Retail and Services	1	20	0	0
Railroads and Public Utilities	3	30	2	20
Finance and Insurance	15	45	8	24
	47	27%	23	13%
Educators	35	54	24	37
Total	82	34%	47	20%

*Without comment or qualification.

#Of replies received from each group to this question.

Method (c) - Adjusted Income Statement

Method (c) was described as:

> Show in the income statement the amount of depreciation based upon historical cost and, as an additional item, an amount to bring the total charge for depreciation up to the current cost basis. Net income would be reported after the full current cost deduction and the additional provision would be carried to a property replacement reserve.

The opinions as to the use of an adjusted income statement are shown in Table VI. The non-educators considered this to be the second most preferable method (30%), especially strong support being given by the Steel, Petroleum, and Retail and Services groups, while the educators considered it to be the least preferable (19%) of the four methods. As for acceptability, the non-educators gave it second choice and the educators, third.

Table VI

Question 2(c) - Adjusted Income Statement

Group	Acceptable No.*	Acceptable %#	Preferred No.*	Preferred %#
Automobile, Aircraft and Related Industries	3	19%	3	19%
Building Materials	3	43	3	43
Machinery and Equipment	9	31	9	31
Chemicals, Paper, etc.	6	38	5	31
Railroad Equipment, Shipbuilding and Shipping	3	43	3	43
Steel	4	80	4	80
Mining and Metals	5	45	3	27
Petroleum	3	75	3	75
Food, Drugs, Beverages and Tobacco	4	33	3	25
Other Manufacturing	5	26	4	21
Retail and Services	3	60	3	60
Railroads and Public Utilities	2	20	2	20
Finance and Insurance	8	24	7	21
	58	33%	52	30%
Educators	18	28	12	19
Total	76	32%	64	27%

*Without comment or qualification.
#Of replies received from each group to this question.

Apart from the direct answers summarized in Table VI, there were several comments on this method.

> ...we strongly favor what appears to us to be the most simple method. We think that explanatory footnotes, supplementary statements and adjusted balance sheets and income statements would all be more confusing than enlightening to the stockholders and the public. (Food)

> I gave a great deal of thought to the method which I felt the majority of bankers would prefer for showing the current dollar costs of depreciation. It is my opinion that method (c) would best enable the credit officer to make his comparative analysis with no disruption of existing analytical procedures and the advantage of having a separate reserve for anticipated costs in excess of historical depreciation. In my opinion, such a reserve has a great deal of value in forecasting future needs and measuring the effect of inflation. (RMA)

> Item (c) would appear most practical. (Fertilizer)

> With respect to the income statement, we believe it is not only desirable but necessary to reflect a reasonable approximation of the current cost of facilities being consumed if we are to realistically portray current income to the public and the investors. (Steel)

> If our answer to your first question were yes..., I very firmly believe that methods outlined in methods (a) and (b) fall far short of the accounting profession's responsibility, and that the only answer would be to report as indicated in method (c) and (d) with a slight preference for (c). (Chemicals)

> ...we do feel that it could be entirely practicable to develop some means to reflect depreciation on a current dollar basis, and if such a method should be adopted by industry in general it would be our preference to adopt the procedure as indicated in method (c). (Tobacco)

> If we could have depreciation charges in terms of current dollars included in the determination of the rates for our services, I am inclined to think I would answer question No. 1 in the affirmative and report net income on the basis of method (c), and not adjust the balance sheet. (Electric Utility)

> Generally speaking, I consider all four of the methods to be acceptable, although all may not fit all types of business. The one shown under (a) is preferable to me until such time as both regulated and unregulated enterprises are permitted to realize the effects of current cost depreciation. The

one shown under (c) seems to me preferable as the ultimate objective. (Gas Distribution)

Method (a) was marked, but only because price level adjustments as yet are not generally accepted. If price level adjustments were generally accepted, I feel that plant and equipment should be shown at historical cost on the balance sheet, additional depreciation to recognize the rise in price level should be reflected in net income, and the resulting credit to date should be included as a separate reserve in the capital stock and surplus section of the balance sheet. (Gas Distribution)

Method (d) - Adjusted Balance Sheet and Income Statement

Method (d) was described as:

> Adjust both the balance sheet and the income statement to show current cost and historical cost of plant and equipment and their depreciation. Net income would be reported after the full current cost of depreciation.

The opinions as to the adjustment of both the income statement and the balance sheet are shown in Table VII. Of the non-educators, only 16% considered this method to be acceptable, and 11%, preferable, the smallest for any of the four methods. The educators agreed with the non-educators as to acceptability, but their preferences rated this method in a tie for second place with method (a), the footnote.

Table VII

Question 2(d) - Adjusted Balance Sheet and Income Statement

Group	Acceptable No.*	Acceptable %#	Preferred No.*	Preferred %#
Automobile, Aircraft and Related Industries	4	25%	4	25%
Building Materials	0	0	0	0
Machinery and Equipment	3	10	2	7
Chemicals, Paper, etc.	4	25	2	13
Railroad Equipment, Shipbuilding and Shipping	1	14	0	0
Steel	1	20	1	20
Mining and Metals	2	18	2	18
Petroleum	0	0	0	0
Food, Drugs, Beverages and Tobacco	2	17	1	8
Other Manufacturing	3	16	2	11
Retail and Services	1	20	0	0
Railroad and Public Utilities	2	20	2	20
Finance and Insurance	5	15	3	9
	28	16%	19	11%
Educators	14	22	14	22
Total	42	18%	33	14%

*Without comment or qualification
#Of replies from each group to this question.

Three others of those replying approved this method if it were acceptable for income tax purposes, and another approved it if such increased depreciation charges were treated as allowable costs of performing government contracts. Other comments were:

> In our opinion method (d) is probably the preferable method. While we do not believe it essential to restate the balance sheet for items of plant and equipment it might be desirable where there is a significant discrepancy between cost and current value. Such restatement should not be rigid, however, but rather should allow flexibility to adjust balance sheets by an approximation of the difference between original cost and current replacement cost by use of an appropriate index. (Steel)

> We have indicated our preference as method (d), although we would have no objection to method (c). Method (d), however, would have the advantage of reporting the increase (or decrease) in equity resulting from changes in the price level. (Cement)

> At no time should the impression be given that depreciation upon the basis of current cost is "wrong" or even that depreciation based on historical cost is "right." For this reason I strongly advocate method (d). (Machinery)

> Supplementary schedules, explanations, or footnotes to explain the need to retain so-called profits are of little value when the accountant's certificate places a stamp of finality on the figure representing profit. It is difficult to explain the need for tax relief provisions, or to determine equitable wage levels, or explain any economic facts when your own published statements refute your testimony. (Petroleum)

Other Methods

Several of those who submitted comments on the methods of disclosure recommended procedures which differed in some respects from any of the four included in the questionnaire.

> /In method (a) the/ footnote should also indicate accumulative reserve providing for current cost of replacement to indicate surplus which should be reserved for this purpose. (Machinery)

> We have...concluded that any calculation beyond cost depreciation should never be reflected in the income statement or shown as an adjustment of the net income; therefore, not as an adjustment to surplus. Depending upon the situation and the opinions of management, it may be appropriate to refer to this difference in the president's letter or the text of the annual report, but in no event should it be a part of the financial statements. (Petroleum)

> ...it is our opinion that this subject should be covered in the general comments of mangement to stockholders and should not be dealt with in the balance sheet or income account. (Bank)

> Prefer explanatory paragraph in report to stockholders. (Floor Coverings)

> A clearly stated footnote seems preferable to a complete supplementary statement, which might be confusing to the average reader of Annual Reports. Later,if it becomes more general practice to report this kind of information, a single statement with two columns of figures, having clearly explained headings, might be helpful. (Chemicals)

> /In method (b) there should also be a/ supplementary schedule to show current and historical cost of plant and equipment. (Educator)

> Temporarily /method (b)/ seems preferable. After using this method we should move to method (c). (Educator)

> /Method (b) preferred/ with current dollars used for all other items in financial statements also. (Educator)

> A replacement cost index would have to be pre-approved by the Government (for use by a specific industry or by all industry) in order to warrant recognition for Balance Sheet purposes. Then, in order to prevent reporting depreciation

in excess of cost, the difference could be handled as suggested in method (c) or the cost could be raised according to the index with a separate Surplus Reserve account for the increased asset valuation. (Chemicals)

My preference would be a modified method (b): Present the ordinary statements and also present income statement and balance sheet with the historical dollars included in depreciation cost, plant cost, and total accrued depreciation converted to the common denominator of current dollars; the necessary credit in the supplementary balance sheet should be to a capital adjustment account. (Educator)

I favor a supplementary statement showing the current dollar cost of depreciation <u>and other costs</u> where changes are significant, plus a complete conversion of position statement items. (Educator)

Instead of method (c) I would prefer method (b) accompanied by another supplementary statement of surplus showing the additional depreciation as earmarked surplus. (Educator)

[In method (c) the] additional provision would be carried to a capital adjustment for price level changes. (Educator)

[In method (d)] net income would be reported after the full current cost of depreciation, and the net income had historical cost depreciation been used would also be indicated. (Educator)

I would favor a modification of method (c). This would be to show historical cost depreciation in the income statement and arrive at net income in the presently accepted manner, but to show as a further deduction from this regular net income figure, the additional depreciation necessary to bring the total to the current cost basis. Thereafter, a new net income figure would be shown which would more properly reflect real earnings. The additional provision for current cost depreciation would be shown on the liability side of the balance sheet as a property replacement reserve and would, in effect, be a segregation of surplus. (Steel)

I have shown my preference to be method (a), that is, reporting net income in the presently accepted manner with a footnote showing depreciation in current dollars. However, I think an equally good if not better method, provided balance sheet appreciation were shown, would be to include current dollar cost of depreciation in full in the income statement and also credit to income in the same period the offsetting absorbed appreciation, the difference between current dollar cost of depreciation and actual cost of depreciation as presently computed. This, of course, would reflect no change in net income. (Containers)

I believe that depreciation based upon historical cost should be used to determine net income. I would recommend, however, that a surplus reserve be established and adjusted each year for the excess of depreciation based upon current value over the amount of depreciation based upon historical cost. The amount of the adjustment to this surplus reserve each year should be disclosed. (Machine Tools)

Whenever the amount by which the current dollar cost of depreciation exceeds depreciation based on historical cost is considered material, it could be shown in the financial statements as an appropriation of retained earnings or perhaps as a deduction from the net income before the balance thereof is carried to retained earnings. The offsetting credit would, of course, be shown as a separate item in the stockholders' equity section of the balance sheet. Regardless of whether this method or one of those suggested in 2a or 2b of the questionnaire were used, it would be incumbant upon management to fully explain the significance of the figures to the stockholders in the text of the report. (Tobacco)

EFFECT OF INCOME TAX CONSIDERATIONS UPON OPINIONS

The answers to the questions, together with the comments made in accompanying letters, indicated that much stronger support would be given to some recognition of the effect of price-level changes upon depreciation if current costs could be used as the basis for depreciation for income tax purposes. Questions 4 and 5 in the questionnaire related directly to the income tax factor.

Question 4 was:

> Would you favor reporting to stockholders a figure for net income which reflects charges for current cost depreciation, if current cost depreciation were accepted for income tax purposes?

The answers to question 4 are shown in Table VIII. In every group there was a majority, and usually a large majority, in favor of disclosure of an adjusted net income figure if current cost depreciation could be used in the calculation of taxable net income.

Table VIII

Question 4 - Adjustment Accepted for Income Tax Purposes

Group	Answers* Yes	Answers* No	% Yes	% No
Automobile, Aircraft and Related Industries	17	5	77%	23%
Building Materials	12	2	86	14
Machinery and Equipment	35	10	78	22
Chemicals, Paper, etc.	14	5	74	26
Railroad Equipment, Shipbuilding and Shipping	7	3	70	30
Steel	10	0	100	0
Mining and Metals	8	4	67	33
Petroleum	7	3	70	30
Food, Drugs, Beverages and Tobacco	19	7	73	27
Other Manufacturing	22	6	79	21
Retail and Services	8	6	57	43
Railroads and Public Utilities	9	7	56	44
Finance and Insurance	34	3	92	8
	202	61	77%	23%
Educators	48	17	74	26
Total	250	78	76%	24%

*Without comment or qualification.

Question 5 was:

> Would you favor reporting to stockholders a figure for net income which reflects charges for current cost depreciation, even if current cost depreciation were not accepted for tax purposes?

The answers to question 5 are shown in Table IX. In only two groups, the steel companies and the educators, was there a majority in favor of disclosure under these circumstances. If an attempt were made to include the opinions of those who qualified their answers, the percentage of "Yes" answers would be slightly increased, but a substantial majority would still be opposed to disclosure of an adjusted net income figure unless it could be used for income tax purposes.

Table IX

Question 5 - Adjustment Not Accepted for Income Tax Purposes

Group	Answers* Yes	Answers* No	% Yes	% No
Automobile, Aircraft and Related Industries	7	15	32%	68%
Building Materials	4	9	31	69
Machinery and Equipment	13	29	31	69
Chemicals, Paper, etc.	2	16	11	89
Railroad Equipment, Shipbuilding and Shipping	4	6	40	60
Steel	4	3	57	43
Mining and Metals	5	8	38	62
Petroleum	2	7	22	78
Food, Drugs, Beverages and Tobacco	1	25	4	96
Other Manufacturing	8	20	29	71
Retail and Services	2	11	15	85
Railroads and Public Utilities	3	13	19	81
Finance and Insurance	13	22	37	63
	68	184	27	73
Educators	44	19	70	30
Total	112	203	36%	64%

*Without comment or qualification.

In spite of this apparent reversal of opinion, a more detailed analysis indicates that the majority adhered to a consistent position. Of the 246 "Yes" answers to question 1, "do you think that the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders?" 229 gave answers to questions 4 and 5 without comment or qualification. The distribution of the answers was as follows:

Combinations of Answers	No. of Answers
Question 4 Yes and Question 5 Yes	108
Question 4 Yes and Question 5 No	84
Question 4 No and Question 5 No	37
	229

Of the 37 who answered "No" to both questions, 28 had expressed a preference for method (a): "Report net income in the presently accepted manner with an explanatory footnote disclosing cost of depreciation in current dollars," and had, therefore, given answers consistent with that method. It could be said, then, that 93, or slightly less than half, gave answers which appeared to be inconsistent with the position they took in the first question. Of the 85 who gave unqualified "No" answers to the first question, as being generally opposed to disclosure of current cost depreciation, 37 were inconsistent and gave approval to disclosure if current cost depreciation could be taken for income tax purposes.

Extensions of the answers to the first question: "do you think that the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders?" sometimes included comments on this point:

I feel strongly that current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders to prevent misleading overstatement of profits. At the same time, it is perhaps more important to obtain a revision of the income tax law to allow a practical procedure for deducting current cost depreciation from taxable income. (Steel)

Until current dollar depreciation charges gain recognition in some form for tax purposes, we do not believe that they should be reflected in formal corporate reports to stockholders, such as the earnings statement and the balance sheet. We believe these statements should reflect only the earnings actually available for dividends or reinvestment, and should not be complicated by theoretical figures which cannot be realized. A separate discussion of the matter might reasonably accompany financial reports. (Farm Equipment)

We /a public utility/ do not see that a useful purpose will be served by reporting, at this time, current dollar cost of depreciation as well as the historical cost depreciation required by the uniform system of accounts; and especially when current dollar costs of depreciation are not subject to deductions for federal income tax purposes... (Electric Utility)

Since our position hinges on income tax considerations which are not reflected in items 1 through 3, we have not attempted to express a view on these relatively mechanical accounting problems. (Railroad)

Yes, but only if current cost depreciation were accepted for income tax purposes. (Floor Coverings)

Other answers included qualifications relating to the acceptability of current cost depreciation for income tax purposes.

/A preference for method 2c, adjustment of the income statement, was/ contingent on acceptance for Federal income tax purposes. (Steel)

/Method 2d, adjustment of both the balance sheet and Income statement, was preferred/ if acceptable for tax purposes. (Farm Equipment) (Retail)

/Disclosure of the amount of current dollar cost of depreciation should be mandatory/ if allowed for income tax purposes. (Farm Equipment) (Retail) (Floor Coverings) (Finance Company)

/We/ have not used any of the methods discussed above in your questionnaire. Among /the/ reasons are: 1, No tax advantage existing at present... (Aircraft)

We believe that an additional provision to reflect current dollar cost of depreciation serves no real purpose unless allowable as an income tax deduction... (Building Materials)

There would be no present Federal income tax advantage in calculating depreciation upon a replacement-cost basis. (Food)

We would like to see corporate reporting on the basis of current cost values if such depreciation could be used for income tax purposes. (Food)

We also oppose the reflection of charges for current cost depreciation, unless this were accepted for income tax purposes. We think the burden on net income would be far too much if the additional charges were not allowed for income tax purposes. (Food)

We believe that the most important phase of current dollar cost of replacements is that such current costs be recognized as a basis for depreciation allowances under Federal income tax laws. If this were accomplished, then some appropriate treatment might be devised for the tax benefit arising from the differential between historical and current dollar costs. Without such recognition, we believe that adjustments to reflect current costs would confuse most stockholders. (Sugar)

If tax regulations were to permit the deduction of depreciation on a current cost basis, we of course would generally be inclined to recognize this privilege to temporarily, and possibly permanently, conserve cash. (Machinery)

I for one think that as long as we have the present tax rules, we must abide by them and we cannot afford to keep two sets of books... (Locomotives)

It is my opinion that no action should be taken with respect to this subject by a corporation in its income account or balance sheet unless the additional depreciation is allowed for tax purposes. (Retail)

I suspect that in a debate on the subject I would be inclined to start out on the negative...but...it would depend on the assumption about taxes. (Electronics)

...unless there is some change in the present tax laws allowing additional depreciation any attempt to reflect the current dollar cost in published reports could become misleading. (Office Equipment)

As Federal Income Tax plays such an important part in the net profits reported, it would seem that to adopt any method of reporting which took cognizance of the inflationary trend when such method of reporting would not be recognized for income tax purposes would result in very little, if any, clarification. (Unclassified Manufacturing)

I believe that /public utility/ corporate reports to stockholders and others should reflect as accurately as feasible the cost of depreciation in current dollars, provided the corresponding revenues include an amount to cover this item and corresponding recognition is included in the computation of income taxes... (Gas Distribution)

It seems to me that reporting to stockholders a figure for net income which reflects charges for inflationary costs is a distinct and separate problem from Internal Revenue tax disposition. (Gas Distribution)

We believe that if current cost depreciation were accepted for income tax purposes, regulatory authorities would be forced to permit normalizing such tax savings by charges to income, such charges reflecting the minimum measure of current dollar cost depreciation to be included in the accounts. Otherwise, the amount reported for Net Income would be increased and the additional tax depreciation would be reflected as a reduction in cost of service, thus depriving the utility of the tax benefit presumably granted to facilitate financing of plant replacements. In the event normalization accounting were permitted, it would be appropriate for current dollar cost depreciation allowed for calculations of federal income taxes to be reported to stockholders. (Electric Utility)

I think the question is largely one of endeavoring to obtain tax relief through stepped up depreciation in recognition of high replacement costs... (Railroad)

Although accounting methods theoretically should not be governed by tax implications, the fact that income taxes currently are an element of such overwhelming importance in the determination of net income dictates that the accounting treatment for any proposal affecting a major element of income cannot be considered separately from the proposed treatment of that element for tax purposes. Therefore,... we would favor reporting to stockholders a net income figure which includes current price depreciation <u>if</u> it were allowed for income tax purposes. (Railroad)

If the current price theory of depreciation were adopted without obtaining appropriate tax treatment, reported earnings of the heavy-investment industries - particularly the railroad industry with 75-80% of total assets locked up in long-lived property - would show a proportionately greater drop than those of other industries. (Railroad)

...acceptance for income tax purposes alone would not necessarily justify a charge to income. (Aluminum)

You will note we have answered your question 5 in the negative. We recognize, of course, certain values in correcting reporting practices even though no tax benefit might be derived. However, to reply in the affirmative could tend to obscure the main objective of tax relief. (Petroleum)

So long as current cost depreciation cannot be used for tax purposes, there is no real purpose served in calculating theoretical retained earnings as if it were deductible. (Farm Equipment)

EFFECT OF TECHNOLOGICAL CHANGES

If "current dollar cost" is interpreted as literal replacement cost, technological changes may do much to counterbalance the effect of rising price levels. In some industries there will be little, if any, literal replacement. Improved methods of construction and production may result in maintaining productive capacity at no increased cost or even less cost per unit of product. On the other hand, if the problem is conceived as merely adjusting original cost for changes in the purchasing power of the dollar, the effect of technological changes would not be relevant.

In order to obtain an expression of opinion as to the effect of technological changes, question 6 was included which read as follows:

> Do you believe that technological changes in the productivity of new plants counterbalance the effect of rising price levels?

There were so many qualified answers to this question, that a table showing the results will not be presented. The totals of the answers submitted without comment or qualification were: "Yes, 34; No, 184," but if comments such as "varies" or "to an extent" are considered to be affirmative answers, the results were: "Yes, 143; No, 187." Apparently, the majority felt that in most cases the price-level problem was not eliminated by technological changes in construction and production methods.

Some of the comments on technological changes were:

We do not believe that technological changes in new plants counterbalance the effect of rising replacement price levels in our industry. (Sugar)

If technological changes had increased productivity to the point of counterbalancing rising price levels there would be no problem. But our labor union style of inflation produces higher costs without waiting for technological improvement. Therefore technological changes counterbalance only in part the effect of rising price levels. (Paper Products)

In general, we do not believe that technological advances have counterbalanced the effect of rising price levels, except in high volume operations where equipment has a high degree of utilization. (Farm Equipment)

It appears to us that technological changes in productivity of new plant counterbalances, in varying degrees and not consistently for all plant, the effect of rising price levels. Obsolescence is usually recognized in the accounts only to the extent that the economic life of the asset is shortened. It is not practical to give recognition to obsolescence resulting from efficiency comparisons with more modern equipment. When a new unit of equipment costs twice as much and produces twice that of a similar old unit of equipment, it is difficult to see how current dollar cost can be recognized for the old equipment unless the accounts include accumulated obsolescence relating thereto, taking into consideration also, operation and maintenance costs of the old equipment as compared to the new. In addition, the current dollar cost depreciation, as usually calculated by price indices, does not always give sufficient consideration to the advances which have been made in construction methods and to improved efficiencies resulting therefrom. (Electric Utility)

Regarding question 6, we do not feel that this can be answered "yes" or "no." Certainly there have been many cases where rising productivity has held costs down and thus prevented price increases which might otherwise have been necessary but there have been other cases where this is not true and what the net effect might be we do not know. The whole question of price levels is complex and influenced by many factors besides technological changes in the productivity of new plants. (Building Materials)

The answer to this question in our own case is very definitely "no." Our experience so far is that the additional depreciation charge at new plants is about equal to the savings in out-of-pocket costs. In other words, total manufacturing costs at new plants and at old plants are not significantly different. The only possible savings that may come about are through increases in volume, since our newer plants are being designed for larger capacities than most of our older plants. (Cement)

It may be that technological changes intended to improve productivity have, in some places, offset costs, thereby eliminating the need for increasing prices. However, I feel that in the over-all picture this has not been so. Technological changes have been taking place right along for a good many years but costs continue to mount and business men have been forced to adjust prices to remain profitable. (Member of Robert Morris Associates)

Technological ingenuity may offset inflation but can hardly be assumed to do so as an accounting principle. (Member of Robert Morris Associates)

Our experience shows that since 1940 our construction costs have been increasing at an average rate of approximately 7% per year compounded. This is about the same rate of increase that we have experienced in hourly employment and other costs. Technological changes in the productivity of new plant may tend to, and in many cases do, hold down the rate of increase in unit costs. Regardless of this fact, however, purchasing power recovered in a period of continued inflation cannot equal purchasing power expended if depreciation is tied to original cost. And unless the cost of depreciation is reflected in terms of current dollars, original purchasing power is not recovered and true costs of operations are understated. (Steel)

We do not feel that the greater productivity of new plants due to technological changes effectively counterbalances the sharply rising price levels for construction and new equipment in recent years. (Steel)

No bearing on the problem. (Unclassified Manufacturing)

Certainly, the technological changes in the productivity of new plants should continue to provide greater efficiency per unit of value. However, we fail to see where this has any relation to the question involved. Certainly, these technological advances are not the result of inflation and might have occurred even to a more pronounced degree had the value of the dollar not deteriorated. (Petroleum)

This is besides the point. Depreciation is not taken for purposes of replacing the asset, but to maintain invested capital. (Educator)

EFFECT OF RECENT ADDITIONS TO PLANT AND EQUIPMENT

The opinion is sometimes expressed that, while there may have been a price-level problem during the rapid rise of prices in the '40s, the large amount of replacements and additions to plant and equipment in recent years has substantially reduced the significance of this factor. Question 7 of the questionnaire was included in order to get a reaction to this possibility. It read as follows:

> Do you feel that the large program of capital additions which most companies have undertaken in recent years has for practical purposes taken care of the price-level problem?

Again, there were so many qualified answers that a tabulation and analysis of the direct answers by industry groups would be of little significance. Only 50 gave direct answers of "Yes" as compared with 219 "No." Of the 86 who qualified their answers, around 50 recognized some modification of the price-level problem because of recent replacements and additions to plant and equipment. A large majority, however, apparently felt that this factor has not been significant.

Some of the comments were:

> Neither do we believe that the large programs of capital additions by many companies in recent years have fully taken care of the price level problem. Even though our company has engaged in such a program, there have been such very substantial cost increases that the facilities installed only three to five years ago might now cost as much as fifty percent more to replace. Depreciation charges thereon are, therefore, still inadequate. (Steel)

> Capital additions at present high costs tend to narrow the dollar difference between the "historical cost" method and the "current cost" method of handling depreciation. But if inflation continues, high current costs inevitably become low historical costs. (Paper Products)

> In some cases, rapid amortization and depreciation may have temporarily balanced with current cost accounting. If

so, this is temporary and fortuitous and eventually will have a reverse effect. (Member of Robert Morris Associates)

As long as price levels continue to rise, existing capital assets cannot fully counteract the price level problem in any growing industry. (Chemicals)

Recent capital additions have been undertaken principally to increase capacity. The price level problem would continue to be a factor in older facilities still utilized for current production. (Electronics)

From 1952-54 this may have been true since many prices remained relatively constant. However, prices are currently on the march again, and consequently the price-level problem is becoming increasingly important. (Educator)

The large program of capital additions which many companies have undertaken in recent years has had the effect of expressing a larger and larger proportion of their fixed assets in dollars more nearly approaching the value of present day dollars. If inflation were to be stopped and present day values continue indefinitely, of course, the older plants would eventually disappear, and this problem would no longer be with us. But this is not the case apparently and, hence, the great cost of these capital programs simply is further evidence of the unsatisfactory condition which exists and is one of the factors which has brought it so vividly to the attention of the public. Accordingly, it is our view that neither technological changes nor capital programs will have any influence on making the present method of reporting more satisfactory, but that this particular problem can only be solved either by stabilizing the value of the dollar or by devising a new unvarying medium for reporting the facts of business. (Petroleum)

The substantial capital expansion which most of the regulated public utilities have undertaken in recent years has taken care of the price level problem to a significant extent... However, it must be evident that additions for plant at relatively current price levels can never fully meet the problem of providing funds for replacement of capital assets so long as price levels keep rising. (Electric Utility)

It of course will vary with industries. It has to a considerable extent in our industry and in view of the small proportion of total assets represented by depreciable assets it further reduces the significance of the effect on net income. (Tobacco)

Our answer to this question is...very definitely "no." As we pointed out in our 1956 Annual Report, the undepreciated balance of the original cost of 60% of our total capacity represents less than 5% of our total plant investment. In spite of a substantial capital addition program, 60% of our capacity is absorbing a very small depreciation charge and this manufacturing capacity must sometime, if we are to remain in business, be replaced at much higher price levels. (Cement)

It may well be that for companies in which depreciable assets are a relatively small portion of the total investment and where the life of depreciable assets is relatively short - under 10 years - the combination of technological changes and newly permitted depreciation methods might tend to keep the price-level problem from becoming significant. It is for this reason we believe accounting and tax handling should be flexible so that individual situations can be recognized. However, for much of industry depreciable property does represent a significant investment and the majority of the facilities do have relatively long lives. In such cases even if a magical formula for stopping inflation is discovered and the cost of replacement of facilities should level off it will be many years until facilities purchased some time ago will be completely replaced and depreciation on cost will represent a realistic depreciation allowance. (Steel)

No, not from the standpoint of stating income properly. However, there is some truth to the observation insofar as the funding of plant replacements is concerned. (Electrical Equipment)

My answer is no. It can be true only to the extent of recent high-cost additions in relation to older low-cost plant, and even then only if it is assumed that inflation will not continue. The latter seems unlikely. (Gas Distribution)

In companies such as ours, recent expansion programs certainly tend to minimize the problem, but we believe our situation is more the exception than the rule. (Aluminum)

A large program of capital additions is one of the factors behind the present tight money situation which in itself has contributed to rising costs. Until inflation is controlled and wages are stabilized, prices are going to continue to rise. Consequently, the price level problem will continue to be with us. (Member of Robert Morris Associates)

INTERPRETATION OF "CURRENT DOLLAR COST"

In the first question and elsewhere in the questionnaire, the phrase "current dollar cost of depreciation" is used and at one point the alternative expression "cost of depreciation in current dollars" appears. These terms were not defined so as to distinguish between the two basic approaches to the problem, (1) the replacement cost, current cost, or specific price index approach and (2) the original cost adjusted for changes in the purchasing power of the dollar, the common-dollar, or general price index approach. These two concepts have been characterized(1) as follows:

> ...the current-cost [or replacement-cost] approach has nothing to do with the problems of inflation and deflation. It is concerned only with changes in specific prices. Of what significance is original cost, the advocate of the current-cost approach asks, when it differs markedly from current cost? The basic postulate of accounting that is challenged by the current-cost approach is the original cost postulate.
>
> The common-dollar approach, on the other hand, tells us nothing about the relative merits of original cost and current cost. It can be implemented with no departure from original cost but it does require that original cost be expressed in a new unit of account - a monetary unit of unchanging purchasing power. The common-dollar approach is concerned only with changes in the general level of prices. The basic postulate of accounting that is challenged by the common-dollar approach is the monetary postulate.

(1) Two Approaches to the Problem of Changing Prices, by John W. Coughlan, Journal of Accountancy, August 1957, p. 42.

The only clue in the questions themselves as to which concept was in the minds of those who answered the questionnaire is possibly the answers to question 6, "Do you believe that technological changes in the productivity of new plants counterbalance the effect of rising price levels?" The effect of technological changes upon unit costs of production would be directly pertinent to the replacement-cost approach; assets in connection with which technological changes had taken place would not actually be replaced and literal replacement costs would be of no significance. The technological changes would not, however, be relevent to an attempt merely to state original costs in terms of a constant purchasing-power dollar. From the answers to this question and the accompanying comments which sometimes were submitted, it appears likely that the replacement-cost concept was predominant. (See section on "Effect of Technological Changes," page 50 for an analysis of the answers to question 6.)

The comments made apart from the questionnaire reflect to a high degree the replacement-cost interpretation of the problem, and the concept of depreciation accounting as a provision for financing replacements appears frequently. A variation of the replacement-cost concept, which also appears in the comments, is that the depreciation charge should provide for the maintenance of the productive capacity of the plant; this gets away from the literal replacement difficulty.

It is our feeling that an acceptable manner of calling attention to the additional provision necessary to bring depreciation charges up to the current replacement cost basis would be... (Aircraft)

...we recognize that depreciation of long-lived assets based on historical dollar values is grossly inadequate to provide funds for replacement at current values... (Auto Parts)

From time to time we are asked as to why our company does not take depreciation on replacement cost of capital assets, rather than on original cost, thus providing a depreciation charge which would more nearly reflect the economic values of the day which our sales, costs, and other expenses reflect. (Building Materials)

It seems a more realistic approach would be...to ensure that earnings are not withdrawn from the business to the extent that its ability to replace such property would be in jeopardy. (Aircraft Parts)

...we believe that technological changes in the productivity of new plants do not counterbalance the effect of rising price levels, however, we recognize that these technological improvements do offset a portion of these increases in price levels. (Automobiles)

Our opinion on this matter is influenced by our experience... some years ago. ...we appropriated out of income and set up in a reserve account, an amount calculated to bring the depreciation up to current replacement cost. (Building Materials)

...if one has the replacement cost of the fixed assets to compare with the book figures, the amount of adjustment in the depreciation figure to bring it to a current basis could be approximated... (Chemicals)

...the major problem...is obsolescence of process and product rather than physical wear and tear of facilities. This results in less emphasis on replacement of facilities in kind...and more emphasis on providing plant facilities geared to changes in industry technology... (Chemicals)

The replacement cost of the new machine far exceeds that of the machine which it replaces and the depreciation reserves which have been accrued are in most cases totally inadequate. (Chemicals)

...innovation proceeds at a rapid pace, and frequently it is possible to replace older plants with units sufficiently more productive or more economical to install as to offset the inflation in construction costs in whole or in part. (Chemicals)

...I do not believe that inflation has reached the point where the recognition of replacement value in the accounts is sufficiently important to overcome the practical difficulties... (Chemicals)

...in most cases a new facility built with current dollars would be more efficient and less costly to maintain than one which is five, ten or fifteen years old. Therefore Providing depreciation on an old facility based upon current construction dollars, with no recognition of other factors, would not give a realistic picture of earnings. (Electronics)

...if facilities were replaced, management would be in a position to improve the efficiency per dollar of plant investment. Unless this improvement in efficiency is reflected in the operating statement, the increased charge as indicated in the depreciation item would be meaningless. (Electronics)

...in the case of old office buildings, it would no doubt be misleading to adjust the value of these upward on the basis of the original cost when modern taste, architecture and demand do not require the costly "gingerbread" construction of several decades ago. Likewise in the case of industry, new concepts and practices have entirely changed to make processes of thirty years ago obsolete. (Fertilizer)

While we fully recognize that ordinary depreciation based upon historical cost will not provide adequately for replacement, we do not believe that the financial statements of a company should be modified to reflect these conditions. (Food)

The purpose of the depreciation charge...is, in effect, to set aside a portion of the sales revenue to provide for the cost of maintaining the plants and equipment at a level adequate to serve the purposes for which they are acquired. (Food)

...this type of accounting would serve to accentuate the inflation spiral due to basing costs on anticipated expenditures rather than actual current costs. (Food)

...we favor any method that can be arrived at to afford higher depreciation rates...so that more of our current earnings can be retained for the purpose of replacement of old and obsolete equipment. (Food)

Only confusion can result by attempting to stretch this term /depreciation/ to include the cost or replacement facilities or the economic differences in our dollar currency. (Food)

We believe that the most important phase of current dollar cost of replacements is... (Sugar)

It is not conceivable that /our buildings/ would have to be rebuilt except in the event of destruction by fire... (Liquor)

It is therefore essential that the profit as reported be a realistic and fair showing of the results of the businesses' operations. This is not true if depreciation is based upon historical cost and if therefore the funds required to replace fixed assets at current cost must be obtained in part from profit. (Machinery)

In general, we feel it might be helpful to the public if financial statements included a footnote indicating current replacement value of depreciation charges... (Machinery)

It would be a rare case when all of machine tool equipment would be replaced suddenly and simultaneously. (Machinery)

...it would seem to us that the only way to correct the condition is to be more realistic in corporate public reporting by reflecting in the accounts the amount by which depreciation recoveries have fallen short of replacement costs. (Aluminum)

Accounting based upon replacement costs would fluctuate from year to year and would be open to wide variances among companies. (Mining)

The failure of cost basis depreciation to recognize inflation results in the draining of working capital merely to maintain existing plant investment and capacity. (Metal Fabricating)

Because depreciation based upon historical costs has not provided sufficient funds to meet replacement costs, industry's reported earnings have been overstated... (Petroleum)

Certainly the accounting profession should recognize that any amount that must be reinvested in the business to maintain assets at the same level of productivity cannot constitute profit. (Petroleum)

...the first question refers to the current collar cost of depreciation, but I am sure this means depreciation calculated on the replacement value of the assets used. (Petroleum)

The idea of taking depreciation on replacement costs is one I have given much thought to for many years... (Petroleum)

It has, of course, been well known for many years that a machine which originally cost $5,000 now costs $20,000 and that if we are accumulating depreciation on the old machine we are obviously not going to have enough to buy the new. (Locomotives)

I believe most everyone agrees that the increased cost of almost everything has made the provision for depreciation... inadequate to serve the purpose for which it was intended; namely, to provide funds for the replacement of plant and equipment after they have served their normal expectancy. (Railroad Cars)

As to the short lived assets,...this class of asset is constantly being renewed and replaced and we are never very far away from replacement cost in our average actual costs. (Retail)

Retained earnings should be for expansion of the business. They are misnamed when they must be added to depreciation provisions for mere replacement of assets consumed in the ordinary course of business operations. (Retail)

We are quite aware of the argument that depreciation calculated on original costs, where such costs are lower than current costs, tends to overstate corporate profits. The basis of this theory seems to be that depreciation charges on the income statement should provide for asset replacement rather than amortization of asset costs... (Mail Order)

We believe that recognition of the difference between actual cost and replacement value of facilities and the related effect on depreciation and profit should be limited to an explanatory statement. (Rubber and Tires)

...each subsidized operator has available to a certain extent profits which have been deposited in their Special Reserve Fund to be used for the replacement of vessels. (Shipping)

...any adjustments to depreciation charges would present a distorted picture. We would be trying to relate future costs to current selling prices... (Shoes)

I am inclined to believe that most of the answers received will be from those who feel very strongly that depreciation should be figured on current replacement values. (Soap)

Unless a means is devised...to permit the recovery of additional current replacement cost through charges to income, the result can only be a powerful deterrent to growth and expansion. (Steel)

We approve in general the principle that there is a need for giving recognition in financial reporting to depreciation based on current replacement costs of plant and equipment. (Tobacco)

We...believe that some consideration should be given to higher current cost for replacement of old plant facilities. (Tobacco)

...to the extent that the depreciation charged exceeded depreciation based on historical cost, that period's income would be burdened with part of the cost of replacement of assets which would be acquired and used in the future... (Tobacco)

We believe if it were possible to secure help in raising these funds [for improvements] through increased depreciation charges based on present day replacement cost, the problem would be partially solved. (Railroad)

I am not in favor of a restatement of our accounts so that the books will reflect depreciation, not on basis of actual cost, but on a much higher figure representing estimated present-day cost of replacement of our property. (Railroad)

The inflationary trend...should level off and then reverse itself. If that be correct, then for long-lived property, at the time replacement occurs, the amount accumulated in the reserve should not be significantly different from the then-replacement costs. (Railroad)

I have based my answers on the belief that the depreciation provision should be sufficient to maintain the service capacity of plant and equipment. (Gas distribution)

I think original cost depreciation is no longer realistic, and it is important to progress toward making provision for replacement of plant not provided for through cost depreciation. (Gas Distribution)

Plant that is retired at the end of its useful life is never replaced by a similar plant but most advocates of current cost depreciation assume that the corporation should have dollars reserved sufficient to duplicate such plant. (Electrical Utility)

We do not think it would be realistic to simply apply construction cost indices to this depreciation, since this would not measure the real costs of replacing an existing station with a new modern station... (Electrical Utility)

We have been well aware of the problems arising out of the inflationary trend as it pertains to the cost of replacing capital assets... (Bank)

There appears to be no direct relationship between depreciation and replacement. (Bank)

I do believe that technological changes in recent years materially reduce the over-all problem of price inflation as related to depreciation. (Bank)

For a long time I have felt that not permitting a corporation to depreciate at replacement value rather than at actual cost in effect amounts to asking the corporation to pay at full corporate rates an income tax on what is actually a capital gain. (Insurance)

...if we were to start to charge depreciation on the basis of current replacement cost, there could conceivably be repercussions on our real estate tax assessment. (Financial Analyst)

During the past decade, many corporations have, of course, used not only depreciation but a larger slice of net earnings after taxes to maintain or expand plant position. In reality some of the net earnings so reported probably should have been included in the depreciation reserve... (Financial Analyst)

...I am inclined to believe that good management without using accounting gimmicks in the reports to stockholders will solve the problems of fixed asset replacement... (RMA)

Depreciation expense and the accumulation of funds /for replacement/ are two different things. (Educator)

In only a few instances was there evidence of an assumption that "current dollar cost" referred to the general price-level approach to the problem. Some of these were found in the comments on question 6 (the effect of technological changes).

This is besides the point. Depreciation is not taken for purposes of replacing the asset, but to maintain invested capital. (Educator)

Why make a second error to correct the first? (Educator)

To me, these (questions 6 and 7) are entirely different questions and cannot be equated. (Educator)

...we fail to see where this has any relation to the question involved. Certainly, these technological advances are not the result of inflation and might have occurred even to a more pronounced degree had the value of the dollar not deteriorated. (Petroleum)

Not related. (Bank)

Sounds like a case of trying to compare apples with cows. (Member of RMA)

Some of the general comments also seemed to indicate that the writers had in mind the decline in the general purchasing power of the dollar rather than the increase in replacement costs.

> Why shouldn't we also recognize the effects of inflation on the other balance sheet accounts, such as the debt on the property itself? (Chemicals)

> ...a price level comparison of current depreciation... could bear little relationship to the amount required to be set aside from income for actual replacement of facilities. (Electronics)

> We believe there are a number of factors, such as the payment of long term debt with cheaper dollars, not reflected in the profit and loss statement and the balance sheet which are of equal or greater significance than price level depreciation to the proper reporting on business activities and results. (Fertilizer)

> The over-all concept of uniform dollar recording must be solved before we can attack just one segment of it. With the trend toward devaluation of the American dollar over the past decade, obviously the comparability of prior statements to present ones is lost. (Liquor)

> ...in each annual report...we emphasize the difficulties arising from expressing monetary values in a unit that is constantly depreciating... (Mining)

> I believe that most people would now agree that the instability in value of the dollar itself gives increasing weight to the contention that the dollar is not a proper basis for expressing many of the facts previously reported and, hence, that some better medium should be devised. (Petroleum)

> If a suitable substitute is found, we would hope that it would not only be applied to the element of depreciation expressed annually as a deduction from income, but also to all other matters affecting both the income statement and the balance sheet. (Petroleum)

> It is our belief, therefore, that...there is no need at this time to modify existing techniques in corporate public reporting to meet the problems created by the decline in the purchasing power of the dollar. (Petroleum)

> ...if we were going to depreciate the dollar to its current worth, we should do so all through the statement and not just on depreciation reserves. (Locomotives)

We...have been in favor of the adoption...of some...method by which the allowance for depreciation will enable the taxpayer to properly reflect his purchasing power expended. (Steel)

I am in favor of recognizing current dollar costs, provided the recognition is comprehensive rather than confined to depreciation alone. (Gas Distribution)

I cannot conscientiously answer this questionnaire because depreciation is only one of many possible sources of gain or loss from price level change. (Educator)

I would prefer price level adjustments for all items... (Educator)

There is a fundamental confusion in the way the questions are framed. Some refer to a change in the general price level..., and a concept of changing depreciation requirements for the particular machinery in particular companies. (Educator)

If economic depreciation is used, I would suggest going the entire way and placing all accounting on economic basis. (Unclassified Manufacturing)

The purchasing power of a company's capital deflates as the currency inflates and its capacity to finance not only more expensive capital assets but also higher receivables and inventories is lessened. (Paper Products)

...it would not seem consistent or fair to make current cost depreciation information mandatory while these other [items] are excluded from similar analysis. (RMA)

In addition to these cases in which the comments gave some clue as to the assumed meaning of "current dollar cost of depreciation," there were almost as many more where such a clue was lacking in the discussion. It seems reasonable to conclude, however, that the problem of price-level adjustments of depreciation is commonly being interpreted in terms of replacement costs, and that a common if not prevalent opinion is that a proper calculation of net income should involve the recovery from revenue of the replacement cost of depreciable assets, either assuming literal replacement or replacement of a plant with equal productive capacity.

Appendix A

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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NEW YORK 16, N.Y.

RESEARCH DEPARTMENT
CARMAN G. BLOUGH, DIRECTOR
RICHARD C. LYTLE, ASSISTANT DIRECTOR
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The inflationary trend over the past several years has led committees of the American Institute of Certified Public Accountants again to give careful study to the possible need for modification of existing techniques in corporate public reporting in order to give recognition to the effects of inflation. Of particular interest is the traditional practice of stating depreciation charges in terms of historical cost rather than in terms of current dollars.

As one facet of this study it would be helpful to know whether business managements feel that present methods of reporting are satisfactory to meet the needs of their shareholders and other readers of their corporate statements, or whether, due to continued inflation, managements now believe that reports would be more useful if they reflected in an appropriate manner the current dollar cost of depreciation as well as its historical cost, and whether they believe it is practicable to do so.

To this end, the Institute is directing this letter to the presidents of several corporations and to certain others. We would like very much to have your ideas, by letter, by answer to the attached series of questions, or by both.

Your cooperation will be greatly appreciated, and a summary of the results of the survey will be sent to all who participate. Your answer will be treated as confidential and used only in tabulation of all responses.

Very truly yours,

(Signed) Marquis G. Eaton

President

PRICE LEVEL DEPRECIATION QUESTIONNAIRE

1. In view of changes in price levels, and assuming for the purposes of this question that an acceptable means of measuring such changes is available, do you think that the current dollar cost of depreciation should be reflected in some appropriate manner in corporate reports to stockholders? Yes ________ No ________

2. If your answer to question 1 is "yes," which of the following methods do you consider acceptable:

   a. Report net income in the presently accepted manner with an explanatory footnote disclosing cost of depreciation in current dollars. ________

   b. Report net income in the presently accepted manner, accompanied by a supplementary statement which reflects current dollar cost of depreciation and the adjusted net income. ________

   c. Show in the income statement the amount of depreciation based upon historical cost and, as an additional item, an amount to bring the total charge for depreciation up to the current cost basis. Net income would be reported after the full current cost deduction and the additional provision would be carried to a property replacement reserve. ________

   d. Adjust both the balance sheet and the income statement to show current cost and historical cost of plant and equipment and their depreciation. Net income would be reported after the full current cost of depreciation. ________

   Which of the above methods do you prefer. (Circle your preference.) a b c d

3. If you think the effect of price level changes should be recognized, do you believe there should be a mandatory requirement for disclosing the amount of current dollar cost of depreciation? Yes ________ No ________

4. Would you favor reporting to stockholders a figure for net income which reflects charges for current cost depreciation, if current cost depreciation were accepted for income tax purposes? Yes ________ No ________

5. Would you favor reporting to stockholders a figure for net income which reflects charges for current cost depreciation, even if current cost depreciation were not accepted for tax purposes? Yes ________ No ________

6. Do you believe that technological changes in the productivity of new plants counterbalance the effect of rising price levels?

Yes ______

No ______

7. Do you feel that the large program of capital additions which most companies have undertaken in recent years has for practical purposes taken care of the price-level problem?

Yes ______

No ______

____
(Name of Company)

____
(Name of Individual)

If you do not care to sign the questionnaire, please indicate the following:

(a) As to company officials, the general type of business done by the company.

____

(b) As to others, your profession.

____

Appendix B

OPINION SURVEY ON PRICE-LEVEL ADJUSTMENT OF DEPRECIATION

Summary of Answers* to Questions

	1		2								3		4		5		6		7	
			Acceptable				Preferred													
Group	Yes	No	a	b	c	d	a	b	c	d	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
Automobile, Aircraft and Related Industries	16	7	10	2	3	4	8	1	3	4	8	8	17	5	7	15	1	18	2	17
Building Materials	11	4	4	3	3	0	3	1	3	0	6	5	12	2	4	9	0	10	0	10
Machinery and Equipment	31	11	16	8	9	3	14	4	9	2	14	19	35	10	13	29	4	25	6	30
Chemicals, Paper, etc.	16	4	11	2	6	4	8	1	5	2	8	6	14	5	2	16	3	7	4	10
Railroad Equipment, Shipbuilding and Shipping	8	3	3	2	3	1	3	1	3	0	5	2	7	3	4	6	1	6	2	7
Steel	8	0	1	0	4	1	0	0	4	1	3	5	10	0	4	3	0	7	0	7
Mining and Metals	10	2	7	2	5	2	5	1	3	2	4	6	8	4	5	8	0	10	1	9
Petroleum	5	7	3	2	3	0	0	1	3	0	1	4	7	3	2	7	2	4	4	5
Food, Drugs, Beverages and Tobacco	13	14	9	2	4	2	7	1	3	1	10	14	19	7	1	25	8	13	12	13
Other Manufacturing	22	6	14	5	5	3	11	2	4	2	11	12	22	6	8	20	0	18	2	17
Retail and Services	6	8	3	1	3	1	2	0	3	0	4	3	8	6	2	11	3	7	3	8
Railroads and Public Utilities	10	8	5	3	2	2	4	2	2	2	6	3	9	7	3	13	1	12	1	14
Finance and Insurance	28	7	16	15	8	5	15	8	7	3	10	18	34	3	13	22	7	12	6	25
Educators	62	4	20	35	18	14	14	24	12	14	36	28	48	17	44	19	4	35	7	47
Total	246	85	122	82	76	42	94	47	64	33	126	123	250	78	112	203	34	184	50	219

*Without comment or qualification.

Appendix C

CLASSIFICATION OF COMPANIES FOR ANALYSIS OF RESULTS

Industry	No. Companies	
Automobiles, Aircraft and Related Industries		
Aircraft	5	
Aircraft Parts	8	
Automobiles and Auto Trucks	3	
Auto Parts	7	
Rubber and Tires	2	
Total		25
Building Materials		
Cement	4	
Materials and Supplies	11	
Floor Coverings	2	
Total		17
Machinery and Equipment		
Air Conditioning	2	
Electrical Equipment	4	
Electronics--Miscellaneous	7	
Electronics--Radio and TV	5	
Farm Equipment	6	
Machine Tools	3	
Miscellaneous Machinery	17	
Metal Fabricating	6	
Total		50
Chemicals, Paper, etc.		
Chemicals	11	
Fertilizer	3	
Paper and Paperboard	8	
Others	3	
Total		25
Railroad Equipment, Shipbuilding and Shipping		
Locomotives and Railroad Cars	4	
Railroad Equipment--Specialties	5	
Shipbuilding	2	
Shipping	3	
Total		14

Industry		No. Companies
Steel		10
Mining and Metals		
Aluminum	4	
Coal, Copper and Gold Mining	5	
Other Nonferrous	7	
Total		16
Petroleum		
Integrated	6	
Producers	4	
Refining	7	
Total		17
Food, Drugs, Beverages and Tobacco		
Drugs	4	
Food--Baking and Biscuit	2	
Food--Canning	2	
Food--Confectionery	2	
Food--Corn Products	2	
Food--Dairy	2	
Food--Meat	2	
Food--Other	2	
Sugar	3	
Beverages	4	
Tobacco	5	
Vegetable Oils	3	
Total		33
Other Manufacturing		
Containers--Glass and Tin	3	
Office Equipment	4	
Shoes	4	
Textiles--Apparel	3	
Textiles--Cotton	3	
Unclassified	14	
Total		31
Retail and Services		
Motion Pictures	3	
Department Stores	2	
Drug Stores	2	
Grocery Stores	5	
Variety Stores	7	
Other Retail and Services	2	
Total		21

Industry	No. Companies	
Railroads and Public Utilities		
Airlines	3	
Railroads--Class I	7	
Gas Distribution	4	
Electrical Operating	13	
Other Public Utilities	1	
Total		28
Finance and Insurance		
Banks and Trust Companies	8	
Robert Morris Associates	17	
Finance Companies	3	
Insurance	5	
Financial Analysts	9	
Other Finance	2	
Total		44
Educators		
Deans, Business Schools	58	
American Accounting Association Committee	7	
Chairmen, Departments of Economics	2	
Chairmen, Departments of Accounting	8	
Total		75
		406